



Memorandum

TO: Making Government Work Better
Committee

FROM: Scott P. Johnson

**SUBJECT: QUARTERLY SUMMARY -
CITY'S INVESTMENT REPORT**

DATE: September 11, 2006

Approved

Date

RECOMMENDATION

It is recommended that the Making Government Work Better Committee accept the City's Investment Report for the quarter ended June 30, 2006.

BACKGROUND

As part of the Making Government Work Better (MGWB) Committee's workplan, the Finance Department will present a quarterly report on the City's investment activity. Under separate cover, the MGWB Committee and City Council has received a notification that the comprehensive quarterly report for the period ended June 30, 2006, is available at the City's website (www2.csjfinance.org) and a hard copy is on file at the City Clerk's Office. This report includes a summary of investment activity for the quarter ended June 30, 2006.

ANALYSIS

Summary of Investment Activity – Quarter Ending June 30, 2006

The information presented on the following page highlights the investment activity for the quarter ending June 30, 2006. Information is also provided for the immediately preceding quarter as well as the same quarter in the previous year, for comparison purposes for quarters ending March 31, 2006 and June 30, 2005, respectively.

INVESTMENT SUMMARY

For the Quarter Ended	<u>June 30, 2006</u>	<u>March 31, 2006</u>	<u>June 30, 2005</u>
<u>Total Portfolio</u>			
Portfolio value as of end of quarter ^{(1) (2)}	\$1,232,162,337.83	\$1,124,906,878.83	\$1,255,508,050.56
Earned interest yield	3.944%	3.628%	3.141%
Portfolio effective yield	4.142%	3.731%	3.164%
Dollar-weighted average days to maturity	327	326	417
<u>Portfolio Fund 1</u>			
Portfolio value as of end of quarter ⁽¹⁾	\$1,227,120,084.97	\$1,083,858,614.95	\$1,147,336,909.83
Earned interest yield	3.921%	3.592%	3.096%
Portfolio effective yield	4.137%	3.698%	3.128%
Dollar-weighted average days to maturity	329	337	455

¹Reflects book value (principal plus any purchased interest costs) of investments.

²Total excludes \$678,291,016 in bond proceeds held by trustees for the City of San José (\$583,690,244) and the Redevelopment Agency (\$94,600,772).

TOTAL PORTFOLIO INCOME RECOGNIZED

Accrual Basis

Total Portfolio	<u>June 30, 2006</u>	<u>March 31, 2006</u>	<u>June 30, 2005</u>
<u>Quarter-End</u>			
Net interest earnings	\$11,421,351.67	\$10,106,794.46	\$9,287,038.51
Fiscal year-to-date interest earnings	\$39,961,992.26	\$28,540,640.59	\$32,758,644.48

Portfolio Performance

The total investment portfolio as of June 30, 2006 was \$1.232 billion. This is an increase of approximately \$107.3 million from March 31, 2006, primarily due to the receipt of property tax, tax increment and Triple Flip/Vehicle License Fee payments from the County. For the quarter ended June 30, 2006, the earned interest yield was 3.944%, an increase of 0.316% from the quarter ended March 31, 2006, reflecting the continued overall increase in market yields. The weighted average days to maturity as of June 30, 2006 were 327 days, representing an increase of 1 day from 326 days as of March 31, 2006.

From the quarter ended June 30, 2005 to the quarter ended June 30, 2006, the investment portfolio earned interest yield increased 0.803%. The increase in the investment portfolio's yield is reflective of the maturity of investments purchased in periods of lower market yields and the subsequent replacement by investments purchased in the current market of rising yields. On May 10, 2006, the Federal Open Market Committee (FOMC) raised the federal funds rate to 5.00%, followed by another increase to 5.25% on June 29, 2006. Economic growth continues but has slowed to a moderate rate which strengthens the case for the Federal Reserve to pause in raising interest rates. Investors are interpreting Federal Reserve statements accompanying the rate increases as an indication that the FOMC may be nearing the end of its tightening cycle. As expected by most market analysts, the FOMC did not raise rates at its August 8, 2006 meeting. The next FOMC meeting is scheduled for September 20, 2006.

Investment Strategy

The yield curve became inverted at the end of December 2005, flattening during the quarter ended March 31, 2006 and in the quarter ended June 30, 2006 became inverted in the shorter end of the yield curve with flattening beyond the 5-year maturity range. An inverted yield curve means that the investment yields in the short term are higher than the longer term. In the last quarter (4/1/06 through 6/30/06), due to the rising interest rate environment and the inverted yield curve in the shorter end of the yield curve, we continued our investment strategy to invest in the 12-to-24 month horizon due to a desire to have more diverse investment maturities in the portfolio and due to the high concentration of our current investment portfolio maturing in the next 12 months as result of previous strategies. Given current market conditions and the City's investment policy guidelines, new investments in the portfolio yielded 5.0% to 5.6%. This strategy will help in mitigating market risk, incrementally increase our average interest yield, and expand our weighted average days to maturity.

Interest Earnings

Actual General Fund interest earnings were \$2,250,971 for the quarter ended June 2006 and \$6,714,087 for the fiscal year-to-date. Interest earnings were greater than budgeted earnings estimates by \$1,268,885 for the quarter ended June 2006 and \$3,014,087 for the fiscal year-to-date.

Cash Flows by Major Funds

The monthly comparison of cash balances as reported in the City’s Financial Management System reveals the cyclical changes in balances which over time are reflected in the investment portfolio balances. The monthly balances for the Airport, Capital Projects and Redevelopment Agency reflect the influx of bond sale proceeds and the subsequent expenditures reducing balances over time. Fluctuations in the monthly balances for the General Fund reflect impacts of State budget actions, specifically the “triple flip”, whereby monthly receipts of Motor Vehicle License Fees and a portion of the Sales Tax receipts which were previously received on a monthly basis from the State and are being replaced by property-tax in-lieu payments received semi-annually in January and May. The increase in cash balances for the General Fund at the end of the quarter ended June 30, 2006 also reflects the receipt of property tax in June.

Based on the Treasury Division cash flow projection of June 30, 2006, the total portfolio is expected to have approximately \$448 million in maturities and interest during the next six months, plus approximately \$628 million in revenues. These amounts are more than sufficient to cover the projected expenditures during the next six months.

PUBLIC OUTREACH

N/A

COORDINATION

This report has been coordinated with the City Manager’s Office.

CEQA

Not a project.

SCOTT P. JOHNSON
Director, Finance Department